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S&P: Debt Financing of Infrastructure Could Hurt States' Credit.

DALLAS — States will be hard-pressed to maintain their credit quality if they attempt to fund infrastructure needs solely through traditional tax-exempt debt financing, Standard & Poor's said in a new report.

"According to our assessment, states won't be able to solve the problem of inadequate infrastructure nationally solely through the issuance of traditional tax-supported debt," said credit analyst Gabriel Petek. "Putting a meaningful dent in the infrastructure deficiency will likely require a mix of traditional debt, public-private partnerships, and additional federal engagement."

States would have to issue an additional $1.19 trillion of debt through 2020 to fund their share of the $3 trillion of infrastructure investments regarded as necessary by the American Society of Civil Engineers, Standard & Poor's said. That would raise state debt ratios to a 7.6% of gross domestic product, which S&P considers a high level, from the current and more moderate 2.9%.The states could contribute to reducing the national infrastructure deficit by acting individually to address more of their local needs, Petek said.

"In our view, most states have at least some capacity at current rating levels to issue additional debt," Petek said. "However, the states as a group do not have enough capacity to finance, using traditional tax-supported debt, their historical share of aggregate infrastructure costs without impairing their credit quality."

State and local governments issued an average of $234 billion per year of tax-exempt, new-money bonds from 1996 through 2010, the report said. However, in the wake of the Great Recession, new-money bonds have averaged only $151 billion per year.

The pullback in debt issuance can be attributed at least in part to the recognition by states that the expense of operating and maintaining infrastructure can extend for decades, which adds significantly to total project costs, Petek said.

Public-private partnerships offer a way to fold long-term operations and maintenance costs into the overall project financing plan, he said, noting that most states already have P3 enabling legislation with more expected to follow.

"However, the P3 model can be complex and in certain cases states attempting P3 projects have encountered political opposition," he said.

States cannot expect more financial support for highway projects from an increase in federal transportation funding in the next few years, Petek cautioned.

"Given that the federal government's share of infrastructure project financing has been shrinking in recent years, we don't currently anticipate a large increase in federal funding," he said.

State and local governments could find their transportation funding further imperiled with the penchant by the millennial generation for shorter road trips in more fuel-efficient cars, which curbs gasoline tax revenues, according to a separate new article from Beth Ann Bovino, Standard & Poor's chief U.S. economist.

Millennials (those born between 1982 and 2000) tend to use public transit more than their elders and obtain drivers licenses at a lower rate and a later age, she said.

"This drop in funds available to construct and repair the country's infrastructure could, in our view, weigh on growth prospects for U.S. GDP, as well as states' economies, and, in some cases, where states and municipalities choose to replace the lost federal funds with locally derived revenues, could hurt credit quality," Bovino said.

If the federal gasoline tax of 18.4 cents per gallon had been indexed to inflation when it was last raised in 1993, it now would be more than 30 cents per gallon and bring in $42 billion per year rather than the current $25 billion, she said.

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by Jim Watts

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